

## Employee Misclassification

### Misclassification Hurts the Commonwealth

Businesses that misclassify workers are able to avoid taxes, safety regulations, wage laws, and workers' compensation insurance. If businesses are able to avoid taxes, less money goes into Kentucky's general fund and local government funds to cover basic services for residents, such as infrastructure improvements and police protection. Taxpayers end up paying more because of the illegal activities of these businesses. Most victims of misclassification are workers who are paid below minimum wage and/or are without employer-provided benefits. These workers are forced to use existing social programs that were not meant to support people working full-time jobs.

Operating outside the law enables businesses to:

- have an unfair advantage by illegally lowering costs so they can underbid all others;
- take business away from honest companies, thereby hurting the employees of those honest employers;
- weaken the Commonwealth's economic stability, working conditions, and social fabric



**Commonwealth of Kentucky**

**Labor Cabinet**

## FOR QUESTIONS OR TO REPORT CONCERNS:

**Call: (502) 564-3534**

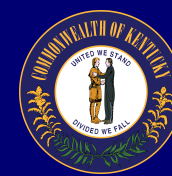
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## Employee Misclassification

**How it affects  
businesses, workers and  
the Commonwealth**



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## Wage Theft

### Employee Misclassification:

#### More than a Crime

Employee misclassification happens when an employer pays a worker as something other than an employee, such as an independent contractor (or 1099 worker), when, in the eyes of the law, that person is *an employee*.

Employment status is not a matter of preference. The classification is made by using the applicable legal standards. An employee is a “W-2 employee” if he or she is on an employer payroll and having payroll deductions and tax contributions made on his/her behalf by the employer. However, an independent contractor is solely responsible for his/her own tax contributions. A true independent contractor is someone in business for oneself.

Employers misclassify workers so they can cut costs and underbid competitors. When a company misclassifies workers, it can hide the actual nature and/or size of its business to insurance providers and government organizations.

Employee misclassification is a form of employer fraud. It's more than just a crime — it hurts the employee, other business, tax payers and more.



## Tax Evasion

### Misclassification Hurts Businesses



Not only does employee misclassification take money from the individual workers who are victims, it also puts other law-abiding businesses at a disadvantage against competitors that can charge less for their goods or services.

The law-abiding businesses end up paying more than their fair share of workers' compensation insurance and unemployment insurance (UI). Uninsured injuries cost the taxpayers of the Commonwealth and legitimate businesses in Kentucky millions of dollars each year.

### What is the punishment for misclassification?

Employers who are caught misclassifying employees face the following:

- Federal and state employment taxes, including any interest and penalties;
- Workers' compensation insurance coverage — and possible penalties for insurance fraud;
- Restitution payments on minimum wages or overtime and penalties;
- Payment of applicable employee benefit obligations.

### The “Underground Economy”

Tax evasion, payroll fraud, under-the-table work, and wage theft are all aspects of the underground economy. It's called “underground” because it's hidden and secretive. The term refers to individuals and businesses which utilize tactics to conceal their actual employment totals, allowing them to skip out on correct wages, payroll taxes and insurance, as well as avoiding safety regulations.

## Payroll Fraud

### Misclassification Hurts Workers

Employees of businesses that don't follow labor and tax laws can be hurt in the following ways:

- They are paid lower wages than required by law;
- The employer may be able to avoid being held accountable in cases of discrimination or workplace injuries;
- Working conditions don't meet safety requirements;
- The employer and employee aren't paying its share of taxes for Social Security and Medicare, so the employee gets no credit toward Social Security eligibility for retirement;
- Benefits are illegally denied or delayed because their wages weren't reported properly.
- Displaced workers fear for their livelihood and feel they can't report violations

